Bank Zachodni WBK

Weekly economic update

16 – 22 July 2012

Beginning of previous week went by in quite stable atmosphere on global markets in expecting for Fed minutes and financial results of US corporates. Moods slightly as a result of the European Commission's decision about extending by one year the deadline for meeting by Spain fiscal deficit target of 3% of GDP, as well as enabling the direct bank's recapitalization from ESM/EFSF after establishing central bank supervision. Fed minutes from June's sitting disappointed investors, indicating that the initiation of QE3 will rather not occur soon, as some on the market expected. Additionally, fears about deteriorating prospects of global economic growth (consequently the central bank of Brazil and South Korea decreased rates) as well as uncertainty about the date of decision by the German constitutional tribunal if the ESM's ratification is legal were factors leading to deterioration of moods in the second half of the week. The cut of Italy's rating by 2 levels by Moody's had little influence on the market and consequently it did not affect the Italian bonds auction and increases on stock exchanges a day later. In Poland, while awaiting Friday's CPI and balance of payments data, clear strengthening occurred on the debt market amid high demand from foreign investors, which was supported by increase of expectations for interest rates' cuts after dovish statements of MPC members (Belka, Bratkowski). CPI data, as we expected, proved to be above market consensus, however correction that it triggered on the interest rate market was moderate. It was accompanied by comments of other MPC members who were less keen to relax monetary policy.

The new week will be much richer in releases of important macroeconomic data, both in Poland and abroad. As regards domestic market, we expect the figures to confirm economic slowdown and show no threats for medium-term inflation prospect. As regards foreign markets, releases of US companies' financial results and information about progress on the euro zone debt crisis front will be most important, apart from macroeconomic data. The end of the week will be crucial in this context, as final agreement about conditions of support for Spain will be made. As regards the Polish FX market, we expect the EURPLN exchange rate to stay is quite wide range of 4.16-4.22 in the upcoming week. If resistance at 4.22 is broken, then the rate may climb further to 4.25.

Economic calendar

Time CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (16 July)					
11:00	EZ	HICP	Jun	%YoY	2.4	-	2.4
13:30	US	Retail sales	Jun	%MoM	0.1	-	-0.2
		TUESDAY (17 July)					
11:00	DE	ZEW index	Jul	pts	-20	-	-16.9
14:00	**PL**	**Wages in corporate sector**	**Jun**	**%YoY**	**3.5**	**3.8**	**3.8**
14:00	**PL**	**Employment in corporate sector**	**Jun**	**%YoY**	**0.2**	**0.1**	**0.3**
14:30	US	Core CPI	Jun	%MoM	0.2	-	0.2
15:15	US	Industrial output	Jun	%MoM	0.3	-	-0.1
		WEDNESDAY (18 July)					
14:00	**PL**	**Industrial output**	**Jun**	**%YoY**	**3.8**	**1.9**	**4.6**
14:00	**PL**	**Construction output**	**Jun**	**%YoY**	**4.5**	**2.9**	**6.2**
14:00	**US**	**PPI inflation**	**Jun**	**%YoY**	**4.7**	**4.8**	**5.0**
14:30	US	House starts	Jun	k	740	-	708
14:30	US	Building permits	Jun	k	755	-	784
		THURSDAY (19 July)					
11:00	**PL**	**Auction of 2Y benchmark OK0714 (offer: PLN2.0-5.0bn)**					
14:30	US	Initial jobless claims	week	k	365	-	350
16:00	US	Home sales	Jun	m	4.60	-	4.55
16:00	US	Leading indicators	Jun	%MoM	-0.1	-	0.3
		FRIDAY (20 July)					
14:00	**PL**	**Core CPI**	**Jun**	**%YoY**	**2.3**	**2.3**	**2.3**

Source: BZ WBK, Reuters, Dow Jones, Parkiet

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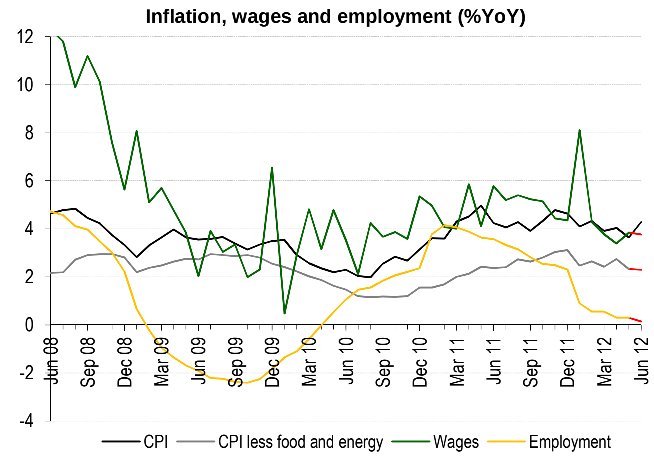
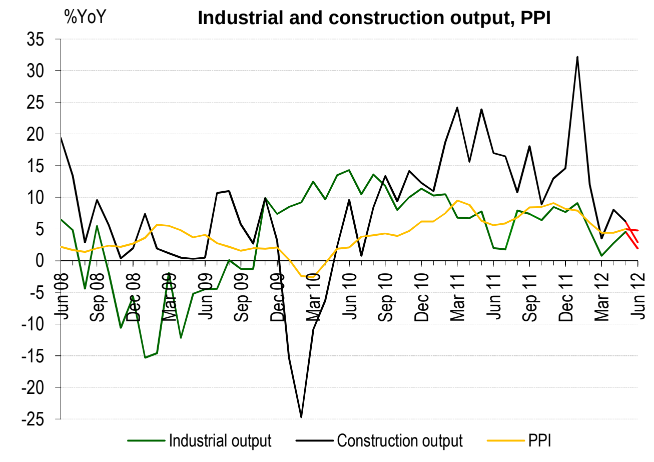
What's hot this week – Further weakening of output and labour market

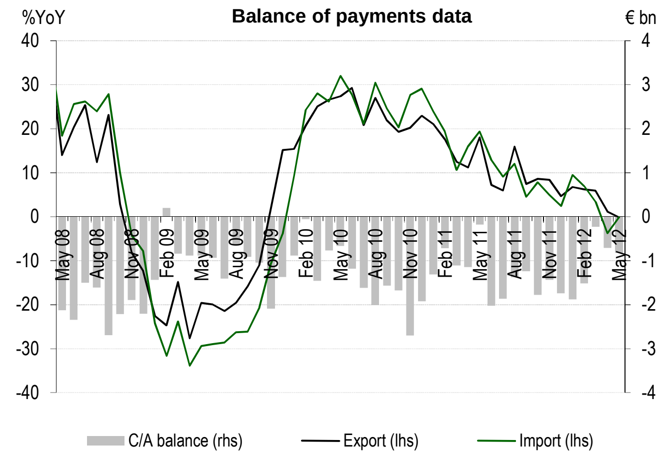


- We expect a continuation of negative tendencies on the labour market. We forecast that the growth of employment in corporate sector slowed down to 0.1% YoY in June from 0.3%YoY in May. In our opinion the number of workplaces will slightly increase in monthly terms (for the first time since January), which is in line with the seasonal pattern, but the increase will be the weakest one in last few years because of the slowdown abroad and poor condition in construction sector.
- According to our forecasts the increase of wages in corporate sector in June remained at the May's level (3.8%YoY), what together with the CPI inflation increase 4.3% YoY and weak employment growth means negative increase of wage bill in corporate sector (-0.4%YoY), what supports our forecast of weakening consumer demand in Q2.



- We expect further slowdown of industrial and construction output growth (1.9%YoY and 2.9%YoY accordingly), which will be influenced by a lower number of working days than a year before. However, the Polish industry will weaken further as a result of falling export orders, especially from the euro zone, where a weakening economic outlook is still observed. The construction sector will also weaken further among others as a result of finishing of investments connected with EURO 2012 and financial problems of companies from this sector.
- The PPI inflation decreased slightly in June, what was influenced by fall of commodities prices on global markets. On the other hand the core inflation (excluding food and energy prices) will show a temporary increase mainly because of increases of accommodation prices in the period of EURO 2012.

Last week in the economy – Higher inflation and C/A deficit



- Inflation rate increased in June to 4.3% YoY, above market expectations. Increasing food prices were main upward factor, while impact of EURO 2012 on hotels and restaurants prices was, contrary to expectations, rather small. CPI will not rather fall below 4% until October, what can prevent the MPC from considering the rates' cuts before the end of the year.
- The current account deficit was in May clearly higher than forecasted because of higher imports and the deficit on the inflows' account. Weak domestic and foreign demand will contribute to remaining of the exports and imports dynamics at low levels in following moths.
- June's money supply data indicates that further slowdown of increase of households and corporate loans. We expect for continuations of these tendencies in remaining part of the year.

Quote of the week – Possibility of using rates to stimulate economy

Elżbieta Chojna-Duch, MPC member, 09.07, TVN CNBC
I think that we should take this (cut) deeply into consideration.

Andrzej Bratkowski, MPC member, 11.07, Dow Jones; 12.07, TVN CNBC
The rates should be cut soon to support weakening economy (…) I think that it (interest rate cut by 50bp in September) would be justified.

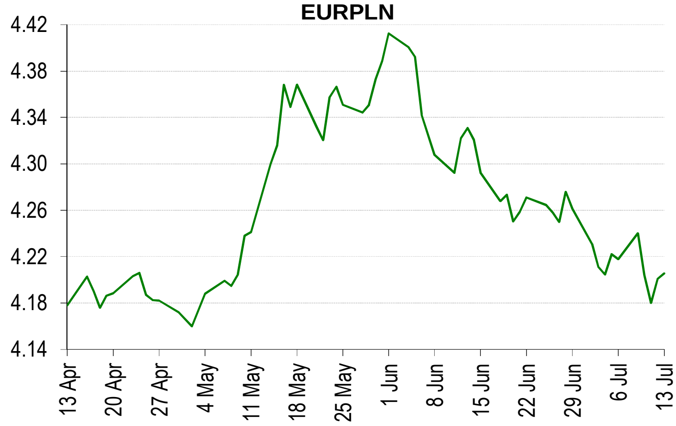
Marek Belka, NBP President, 12.07, Bloomberg
We have the possibility of using interest rates to stimulate economy when needed.

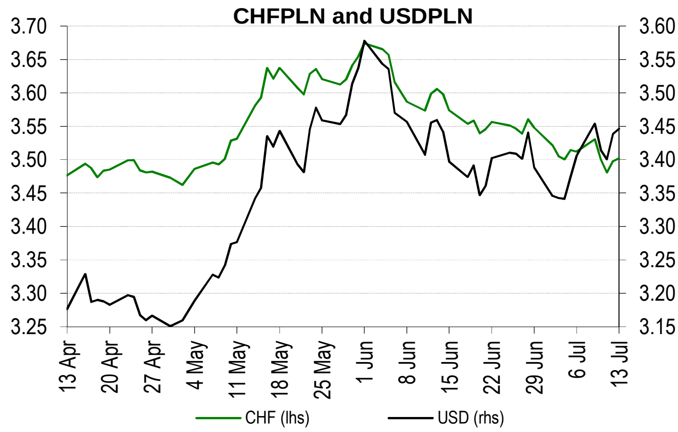
Anna Zielińska-Głębocka, MPC member, 13.07, PAP
I think that current rates' level is appropriate (…) So far I don't see the space for rate cuts.

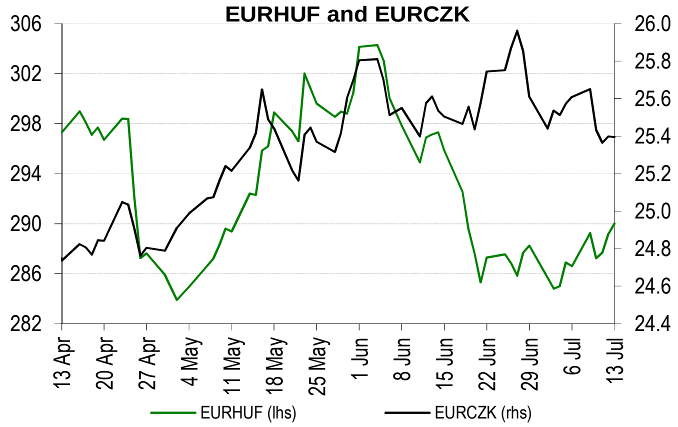
Jan Winiecki, MPC member, 13.07, TVN CNBC
So far I do not see the reason for the change of interest rates toward another direction than it happened during last year.

Dovish stance of two MPC members, who were against rate hike in May (Bratkowski, Chojna-Duch) is not a surprise, even though we can see some evolution of their views. Bratkowski's view is straightforward: a reduction of rates, even a pronounced one, is necessary already in September (earlier Bratkowski spoke about conditional hike). However, Belka's comment seems to be more important, as is can suggest that the NBP President starts to regret the May's rate hike. However, it is worth noting that other MPC members do not seem to think similarly and the higher-than-expected inflation reading in June will surely not soften their stance. We still expect that the interest rates will remain flat until the year-end.

Foreign exchange market – Zloty still under influence of foreign factors







EURPLN consolidates in the range of 4.16-4.22

- The beginning of previous week brought strengthening of zloty against main currencies. EURPLN was easily breaking further support levels and reached almost 4.16 (the lowest level since the May's beginning). The support at 4.16 stopped efficiently the downward trend of the rate, which in following days gradually increased toward 4.20 and higher.
- Higher volatility could be observed in USDPLN's quotations. The rate's fall was stopped by significant support close to 3.39. Following days brought increase toward 3.45.
- This week the zloty should still remain mainly under influence of global factors. However, the data from real economy (labor market data and industrial output data) may in short-run influence quotations of domestic currency. We expect that the EURPLN will remain in quite wide range of 4.16-4.22. Getting through the resistance level of 4.22 would open a way towards 4.25.

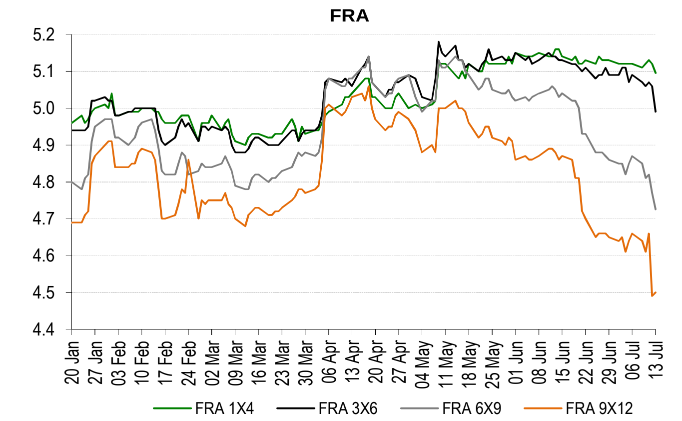
EURUSD at the lowest level since mid-2010

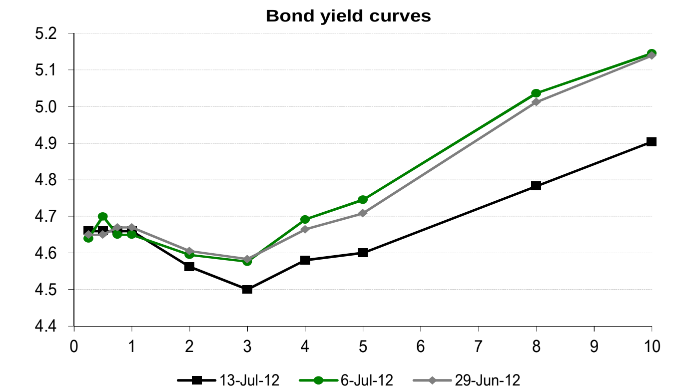
- In previous week the European single currency remained under pressure. On the market the fears about global economic growth as well as information which were coming after the summit of euro-zone's ministries of finance, which indicates some differences in opinions of particular countries about decisions taken on June's EU summit, were influencing market. It concerns among others the necessity of legalising ESM by the German constitutional tribunal, as well as Netherlands' and Finland's objection against using of EFSF/ESM funds directly to support the debt markets of peripherals countries of the euro-zone. The market did not find any support in Fed minutes. Consequently EURUSD decreased temporarily to 1.2165, which is the lowest level since mid-2010.
- This week will bring the release of plenty of macroeconomic data for euro-zone (inflation data, ZEW index for German economy), but especially from the US economy (for example inflation data, real estate market). From the point of view of technical analysis the level of 1.2125 remains the key support for EURUSD and 1.233 is the key resistance (although the rate may stop at 1.224). We expect that in following days the rate may be consolidating in this range.

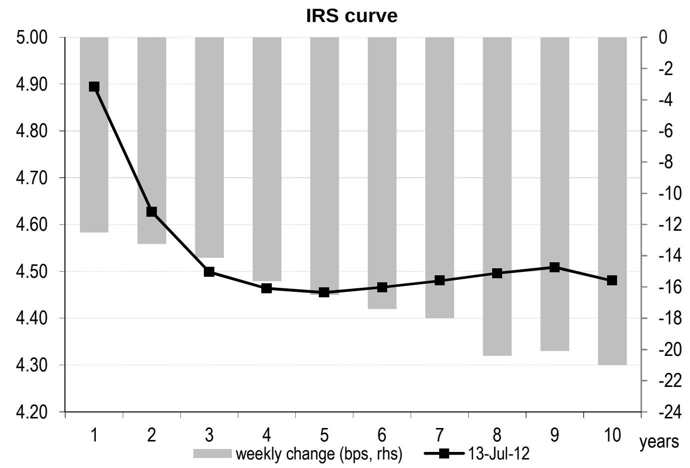
EURCZK still in the upward trend

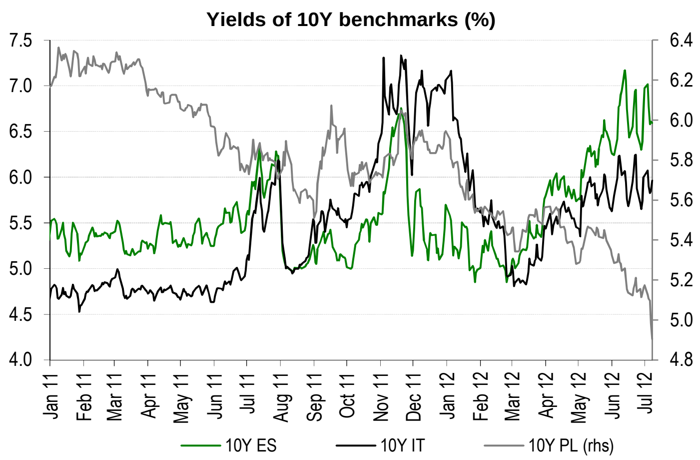
- The trading of other CEE currencies was very similar to tendencies observed on the Polish market. CZK and HUF strengthened against main currencies in first half of the week, while following days brought slight profit-taking. EURCZK decreased to 25.3, while EURHUF fell to 286.7. The second half of the week brought increases of both rates; Hungarian currency lost more its value.
- This week negotiations will start between the Hungarian government and the IMF and the ECB. Their conclusions might be important from the point of view of future monetary policy. The representatives of the Hungarian central bank point out that reaching an agreement will enable the monetary policy easing (Hungarian interest rates are at the highest level in the EU). The negotiations' conclusions may in short-term influence the sentiment on the CEE market.

Interest rate market – Bonds rallied amid strong demand from foreigners









Money market has priced-in significant rate cuts

▪ WIBOR rates have remained relatively stable. However, they increased by 1bps in mid of the week, but it was only temporary move. The week ended with WIBOR3M at 5.13%, while rates between 6M-1Y were near 5.16%. It is interesting that market ignored dovish comments from some MPC's members.

▪ FRA market was more sensitive to changes in the MPC's members rhetoric. More soften comment from Marek Belka, the NBP's Governor, has supported the market and has given some impulse for downward move in FRA rates, especially as for 6x9 and 9x12 rates. Point o view presented by Andrzej Bratkowski from the MPC, who mentioned that interest rate cuts by 50bps might be possible in September, resulted in deeper decrease. At the end of week FRA9x12 decreased below 4.50% and currently it is 65bps lower than WIBOR3M.

▪ Elevated level of WIBOR6M is positive from the WZ series holders. This week the MF will calculate a coupon for a new coupon period between July 2012 and January 2013. If WIBOR6M stabilises at current level, the new coupon will amount to 5.16% in annual terms.

Yield of 10Y benchmark below 5%, at new year low

▪ Polish debt securities, especially mid and long end of the curve, strengthened significantly last week due to strong demand from foreign investors. The rally on the Polish bonds was supported not only by strong fundamentals (compared with other EU countries), by also more dovish statement from the NBP's Governor. Marek Belka highlighted that the Council could use the interest rates to stimulate the economy if needed. As a consequence, yield of 10Y benchmark broke psychological support level at 5% and declined towards 4.90% (drop by 24bps in weekly terms), setting a new this year minimum.

▪ Yield of 2Y benchmark, ahead of CPI inflation release, has stabilised slightly below 4.60%. As we predicted CPI inflation increased in June above 4%YoY, beating market expectations. Despite higher than expected inflation rate, interest rate market reaction was rather limited. The June inflation reading only halted downward trend of yields.

▪ As for IRS, rates have continued downward move. In weekly terms IRS curve moved down by 10-17bps. IRS10Y fell to 4.50%, reaching to the lowest level since September 2011.

Focus on macro data and auction of 2Y bond

▪ This week the attention of investors on the debt market will be on the continuation of macro data publications (labour market figures and industrial production). Output figure may be the key, as it may show further slowdown to 1.9%YoY to 4.6% in May. If such a scenario materialises, this would support GDP growth slowdown below 3% in 2Q12. This may again revive expectations for swift monetary easing, supporting the short-end of the curve.

▪ Also, the auction of two-year benchmark OK0714 will be important event on the debt market. The supply will be known on Monday, but we do not expect a significant change as compared to the plan (PLN2-5bn). The auction will probably attract high interest redemption of OK0712 as well as interest payments fro WZ series.

Additional information is available on request. Please contact Bank Zachodni WBK S.A. Treasury Division, Economic Analysis Unit, ul. Marszałkowska 142, 00-061 Warsaw, Poland, phone +48 22 586 83 63, email ekonomia@bzwbk.pl, http://www.bzwbk.pl